NAVAL PETROLEUM AND OIL SHALE RESERVES

Proposed Appropriation Language

For expenses necessary to carry out Naval Petroleum and Oil Shale Reserve Activities, $16,500,000, to remain available until expended; Provided further that notwithstanding any other provision of law, unobligated funds remaining from prior years will be available for all naval petroleum and oil shale reserve activities.

Note.-A regular 2003 appropriation for this account has not been enacted at the time the budget was prepared; therefore, this account is operating under a continuing resolution (P.L. 107-229, as amended). The amounts included for 2003 in this budget reflect the Administration's 2003 policy proposals.

Explanation of Change

Decrease from the FY 2003 request primarily reflects elimination of the Rocky Mountain Oilfield Testing Center.

NAVAL PETROLEUM AND OIL SHALE RESERVES

Program Mission

Since the NPOSR no longer served the national defense purpose envisioned in the early 1900s, the National Defense Authorization Act for Fiscal Year 1996 (P.L. 104-106) required the sale of the Government's interest in NPR-1. To comply with this requirement, the Elk Hills field in California was sold to Occidental Petroleum Corporation in 1998. Subsequently, the Department transferred two of the Naval Oil Shale Reserves (NOSR-1 and NOSR-3), both in Colorado to the Department of the Interior's Bureau of Land Management. In January 2000, the Department also returned the NOSR-2 site to the Northern Ute Indian Tribe. The Department continues activities to finalize its Elk Hills equity interests with ChevronTexaco, co-owner of Elk Hills. Following the sale of Elk Hills and the transfer of the oil shale reserves, DOE retains two Naval Petroleum Reserve properties:

> The Naval Petroleum Reserve 3 in Wyoming (Teapot Dome field) - A stripper well oil field that the Department will maintain until it reaches its economic production limit. Environmental remediation efforts are underway, and from 1995 - 2003 the field was being used as the Rocky Mountain Oilfield Testing Center (RMOTC).
>
> The Buena Vista Hills Naval Petroleum Reserve 2 in California - A checkerboard pattern of government and privately owned tracts adjacent to the Elk Hills field. Of the 30,181 acres, 10,446 acres are owned by the government and leased by private oil companies. Revenues from 1976 through 2001 totaled $62 million. Discussions have begun with the Department of the Interior on transfer of this asset.

There are four basic programmatic areas that define the current activities of the Naval Petroleum and Oil Shale Reserves (NPOSR):

- Divestiture actions related to the sale and transfer of Naval Petroleum Reserve 1 in California (Elk Hills field)
- Management of leases associated with Naval Petroleum Reserve 2 in California (Buena Vista Hills)
- Production and operation of the Naval Petroleum Reserve 3 in Wyoming (Teapot Dome field)
- Management of Naval Oil Shale Reserve NO. 3 (NOSR-3) in Colorado's environmental assessment and remediation

Program Strategic Performance Goals

- Complete divestiture actions related to the sale and transfer of NPR-1 by FY 2005.
- Maintain positive cash flow for NPR-3 field operations.

Performance Indicators

- Milestones to complete divestiture activities (NPRC)
- Milestones to complete State of California Risk Assessment process (NPRC)
- Crude oil and natural gas production (NPR-3)

Annual Performance Targets and Results

FY 2002 Results	FY 2003 Targets	FY 2004 Targets
Maintain positive cash flow for NPR-3 field operations.	Maintain positive cash flow for NPR-3 field operations.	Maintain positive cash flow for NPR-3 field operations.
	Close out two NPR-1 environmental remediation findings per agreement with CA Department of Toxic Substances Control.	Complete State of California Risk Assessment process.
	Transfer NPR-2 to DOI.	

Significant Accomplishments and Program Shifts

Divestiture of NPRC: Support for the settlement of equity shares with ChevronTexaco, the minority owner of Elk Hills, is a major activity for NPOSR for which geologic, petrophysical and reservoir engineering services are required to prepare and support the Government's equity position before an Independent Petroleum Engineer and the Assistant Secretary for Fossil Energy (ASFE). Under the *Equity Redetermination Process Agreement*, the ASFE is to impartially determine final equity shares between ChevronTexaco and the Department of Energy. The final equity determinations could result in a combined financial impact worth several hundred million dollars for the total of all four of the NPR-1 producing zones. Financial settlements resulting from the equity re-determination process will occur after final decisions have been made for all four zones, by the end of FY 2005. Concurrently, there are environmental remediation and cultural resource activities.

Management of NPR-2 leases: Of the 30,181 acres adjacent to the Elk Hills field, 10,446 acres are owned by the government and leased by private oil companies. The Department currently administers the lease agreements. Discussions have begun with the Department of the Interior for transfer of this asset by October 1, 2003.

Production and Operation of NPR-3: The Naval Petroleum Reserves Production Act of 1976 (P.L. 94-258) directed that the Reserves be developed and produced at their maximum efficient rates for an initial 6-year period. The Act also authorized incremental continued production extensions (up to three years each) based on a Presidential certification that continued production is in the national interest. This certification is supported by a report of an investigation determining the necessity for continued production. Production for NPR-3 is currently authorized through April 2006. Revenue goals for fiscal year 2004 are $4.9 million.

NOSR-3 Environmental Remediation: The Department of Energy is responsible for the assessment and remediation of all environmental liabilities at NOSR-3 that existed at the time of transfer of the reserve to the Department of the Interior's Bureau of Land Management (BLM) in 1999. Public law 105-85, which mandated the transfer of the property, established a special account in the U.S. Treasury into which all lease receipts are to be deposited to pay for environmental remediation and payment of all DOE capital costs incurred in the development of the field. Until recently, the Department of the Interior (DOI) and DOE have been unable to access that account. Recently, Congress approved $1.5 million to assess the environmental remediation requirements at the Naval Reserve. The work will be funded through the special account and the DOE management requirements will be funded with current Program Direction funds.

Funding Profile

(dollars in thousands)

	FY 2002 Comp. Approp.	FY 2003 Request	FY 2004 Base	FY 2004 Request	FY 2004 Request vs. Base	
					$ Change	% Change
PRODUCTION & OPERATIONS						
Production Operations	$8,290	$2,550	$2,550	$3,500	$+950	37%
Environmental Restoration	$2,494	$2,820	$2,820	$5,601	$+2,781	98%
Rocky Mountain Oilfield Testing Center	$4,500	$3,000	$3,000	$0	$-3,000	-100%
Subtotal Production and Operations	$15,284	$8,370	$8,370	$9,101	$+731	9%
MANAGEMENT						
Program Direction	$5,776	$3,755	$3,869	$3,122	$-747	19%
Equity	$6,200	$6,200	$6,200	$2,250	$-3,950	-64%
Business Management & Support	$2,350	$2,506	$2,506	$2,027	$-479	-19%
Subtotal Management	$14,326	$12,461	$12,575	$7,399	$-5,176	41%
Total, NPOSR	$29,610	$20,831	$20,945	$16,500	$-4,445	-21%
Use of Prior Year Balances	$-12,255	$0	$0	$0	$0	0%
Total, New BA, NPOSR	**$17,355**	**$20,831**	**$20,945**	**$16,500**	**$-4,445**	**-21%**
Additional net budget authority to cover the cost of fully accruing retirement (non-add)	($+246)	($+238)	($+238)	($+238)	$0	0%
Staffing (FTEs)						
Headquarters	10	10	10	10		
Field	19	22	22	22		
Total Staffing	29	32	32	32		

Funding by Site

(dollars in thousands)

	FY 2002	FY 2003	FY 2004	$ Change	% Change
NPR – California	$6,244	$6,340	$7,594	+1,254	+20%
NPOSR-Colorado, Utah, Wyoming	$16,982	$8,899	$6,554	-2,345	-26%
All Other	$6,384	$5592	$2,352	-3,240	-58%
Subtotal, NPOSR	$29,610	$20,831	$16,500	4,331	-21%
Use of Prior Year Blances	-$12,255	$0	$0	$0	0%
Total, NPOSR	$17,355	$20,831	$16,500	-4,331	-21%

Site Descriptions

Naval Petroleum Reserve-California

The NPR-California field office, located in Bakersfield, California, is responsible for completing closeout activities from the sale of the Elk Hills site. To meet the deadline set in the Authorization Act, it was necessary for the Department to commit to a number of activities after closing the sale. The commitments were formalized in several legal agreements between DOE, Occidental, Chevron, and the State of California. Activities include finalizing equity ownership; completing environmental and archaeological work; assessing sites where remediation was not completed before the sale; and concluding any lawsuits related to the operation of Elk Hills that had been brought by third parties against the Government and/or its contractors.

Naval Petroleum and Oil Shale Reserves-Colorado, Utah and Wyoming

The NPOSR – Colorado, Utah, Wyoming (CUW), located in Casper, Wyoming supports activities to produce NPR-3 at the maximum efficient rate; provide a testing and demonstration facility at the Rocky Mountain Oilfield Testing Center (in FY2002 and FY2003 only); and restore those areas that will no longer be utilized in oil and gas production at NPR-3.

Funding by Site

All Other

Other activities supporting NPR includes the independent evaluation and recommendation of final equity for Elk Hills being performed by Netherland, Sewell & Associates, Inc of Dallas, Texas as well as the supporting geologic, petrophysical and reservoir engineering services required to prepare and support the Government's equity position before an Independent Petroleum Engineer and the Assistant Secretary for Fossil Energy (ASFE). Program Direction funding for the NPR Headquarters staff (10FTEs) in Washington, DC is also included in this category.

Detailed Program Justification

(dollars in thousands)

	FY 2002	FY 2003	FY 2004
Production and Operations	$15,284	$8,370	$9,101

- **Production Operations 8,290 2,550 3,500**

  Continue to maintain and produce approximately 540 stripper wells at NPR-3 (expected to produce 466 barrels of oil and 1,400 gallons of natural gas liquids per day). Includes routine O&M activities for production facilities, well maintenance, electricity, utilities, buildings, roads, heavy field equipment, motor vehicles and capital projects where warranted.

  FY2003 and FY2002 funding continued routine O&M activities at NPR-3 for production facilities, well maintenance, electricity and utilities, buildings, roads, heavy field equipment, motor vehicles and capital projects to be undertaken provided oil prices warrant such expenditures

- **Environmental Restoration...2,494 2,820 5,601**

  Continue Elk Hills environmental and archeological closeout activities. Clean/close 25-35 sites listed among the 131 California Department of Toxic Substances Control (DTSC) areas of concern. Continue negotiations with ChevronTexaco on the disposition of sites listed on Exhibit H of the Unit Plan Contract Termination Agreement. Perform environmental risk assessments on DTSC's areas of concern. Perform risk assessments on 8 Drill Sites and other Ford City Areas. Continue restoration activities at NPR-3 for reservoirs that are no longer able to produce economically.

Detailed Program Justification

(dollars in thousands)	FY 2002	FY 2003	FY 2004

FY2003 and FY2002 funding continued efforts to close remaining findings at NPR-1 as required by the agreement between DOE and the California Department of Toxic Substance Control (DTSC). Included risk assessment and data recovery work to determine extent of cleanup work at each site. Some cleanup work began. Gathered curation information for NPR-1 artifacts. Also continued plugging and abandonment of 50 - 100 uneconomic wells and closing surface facilities at NPR-3 that were no longer required to support production operations. Removed dry hole markers from wells plugged prior to 1998 and replaced with underground markers; then rehabilitated the sites.

- **Rocky Mountain Oilfield Testing Center..........................4,500 3,000 0**

No activities are included for RMOTC in FY2004. The decrease reflects the elimination of the Rocky Mountain Oilfield Testing Center that does not provide a uniquely Federal function.

FY2003 and FY2002 funding supported RMOTC activities such as geothermal well drilling and geothermal electricity production using heat mining, produced water bioremediation, single entry inclined reservoir drainage concepts and other drilling concepts that will reduce impacts on the environment. RMOTC also participated in the Department's initiative for oil shale technology exchange with the Baltic States.

Detailed Program Justification

(dollars in thousands)	FY 2002	FY 2003	FY 2004
Management	$14,326	$12,461	$7,399

- **Program Direction..5,776 3,750 3,122**

Provide for 32 FTEs: 10 at Headquarters, 22 at the field. FTEs will be used for policy and planning, equity determination, petroleum engineering, financial management, procurement, environment and safety, and administration of reimbursable work programs.

Detailed Program Justification

(dollars in thousands)	FY 2002	FY 2003	FY 2004
▪ **Equity**	**6,200**	**6,200**	**2,250**

Dry Gas Zone, Carneros Zone and Stevens Zone finalized. Shallow Oil Zone independent recommendation due to Fossil Energy in FY2003. Process could take until March 2005 for final Fossil Energy decision. FY2003 and FY2002 funding supported the independent petroleum engineer, legal support, and expert technical analysis/ consultation required to support the final Fossil Energy decision.

▪ **Business Management & Support**	**2,350**	**2,506**	**2,027**

Continue payments for post-employment medical and dental benefits to former Management & Operating (M&O) contractor employees. For NPR-2, ensure environmental compliance of the 17 lease agreements expected to generate $2.0 million in royalty revenues. Continue general operational and administrative support at the field sites.

Explanation of Funding Changes

FY 2004 vs. FY 2003 ($000)

Production and Operations

Increase in NPR-3 Production Operations due to electrical rate changes and increased facilities maintenance........+950

Increase in NPR-1 Environmental/Cultural Closeout activities to support environmental risk assessments on California's Department of Toxic Substance Control (DTSC) areas of concern........+2,781

Decrease due to elimination of RMOTC operations........-3,000

Management

Mandatory increase for Cost of Living adjustment and general pay raises........+ 114

Decrease in Program Direction to reflect elimination of RMOTC activities........-1,362

Increase in NPR-3 operations & environmental restoration support........+501

Decrease in required equity finalization support........-3,950

Decrease in Business Management and Support due to transfer of NPR-2 leases to the Department of the Interior........-479

Total Funding Change, Naval Petroleum & Oil Shale Reserve........-4,445

NAVAL PETROLEUM AND OIL SHALE RESERVES
PROJECTED FEDERAL REVENUES
(dollars in thousands)

	FY 2002			FY 2003			FY 2004		
Naval Petroleum Reserve No. 3									
	Production	Price	Revenues ($000)	Production	Price	Revenues ($000)	Production	Price	Revenues ($000)
Crude Oil	568 BOPD	$23.39	$4,852	525 BOPD	$26.00	$4,982	466 BOPD	$26.00	$4,420
Liquid Products	1,244 GPD	$.36/gal	$164	1,400 GPD	$.40/gal	$204	1,400 GPD	$.40/gal	$204
Other									$308
Total NPR-3			**$5,016**			**$5,186**			**$4,932**
Naval Petroleum Reserve Number 2 -- Royalties from 17 Lease Agreements									
	Production	Price	Revenues ($000)	Production	Price	Revenues ($000)	Production	Price	Revenues ($000)
Crude Oil	159 BOPD	$20.41	$1,184	161 BOPD	$21.41	$1,256	162 BOPD	$24.00	$1,416
Natural Gas	629 MCF/D	$2.17	$497	630 MCF/D	$2.21	$509	636 MCF/D	$2.30	$534
Liquid Products	406 GPD	$.21/gal	$31	404 GPD	$.25/gal	$37	408 GPD	$.30/gal	$45
Total NPR-2			**$1,712**			**$1,802**			**$1,995**
TOTAL NPOSR REVENUE			**$6,728**			**$6,988**			**$6,927**

NAVAL PETROLEUM AND OIL SHALE RESERVES
PROJECTED FEDERAL REVENUES
(dollars in thousands)

	FY 2005			FY 2006			FY 2007		
Naval Petroleum Reserve No. 3									
	Production	Price	Revenues ($000)	Production	Price	Revenues ($000)	Production	Price	Revenues ($000)
Crude Oil	411 BOPD	$26.50	$3,975	362 BOPD	$27.00	$3,564	318 BOPD	$27.50	$3,190
Liquid Products	1,400 GPD	$.40/gal	$204	1,400 GPD	$.40/gal	$204	1,400 GPD	$.40/gal	$204
Other			$308			$258			$258
Total NPR-3			**$4,487**			**$4,026**			**$3,652**
Naval Petroleum Reserve Number 2 (Royalties from 17 Lease Agreements)									
	Production	Price	Revenues ($000)	Production	Price	Revenues ($000)	Production	Price	Revenues ($000)
Crude Oil	168 BOPD	$24.00	$1,470	174 BOPD	$24.00	$1,521	180 BOPD	$24.00	$1,574
Natural Gas	660MCF/D	$2.30	$554	683 MCF/D	$2.30	$573	707 MCF/D	$2.30	$593
Liquid Products	424 GPD	$.30/gal	$46	439 GPD	$.30/gal	$48	456 GPD	$.30/gal	$50
Total NPR-2			**$2,070**			**$2,142**			**$2,217**
TOTAL NPOSR REVENUE			**$6,557**			**$6,168**			**$5,869**

NAVAL PETROLEUM AND OIL SHALE RESERVES
PROJECTED FEDERAL REVENUES
(dollars in thousands)

	FY 2008		
Naval Petroleum Reserve No. 3			
	Production	Price	Revenues ($000)
Crude Oil	280 BOPD	$28.00	$2,862
Liquid Products	1,400 GPD	$0.40/gal	$204
Other			$308
Total NPR-3			**$3,066**
Naval Petroleum Reserve Number 2 -- Royalties from 17 Lease Agreements			
	Production	Price	Revenues ($000)
Crude Oil	180 BOPD	$25.00	$1,643
Natural Gas	707MCF/D	$2.40	$619
Liquid Products	456 GPD	$0.31/gal	$52
Total NPR-2			**$2,314**
TOTAL NPOSR REVENUES			**$5,380**

ELK HILLS SCHOOL LANDS FUND

Proposed Appropriation Language

For necessary expenses in fulfilling installment payments under the Settlement Agreement entered into by the United States and the State of California on October 11, 1996, as authorized by section 3415 of Public Law 104-106, $36,000,000 for payment to the State of California for the State Teachers' Retirement Fund from the Elk Hills School Lands Fund.

Note.-A regular 2003 appropriation for this account has not been enacted at the time the budget was prepared; therefore, this account is operating under a continuing resolution (P.L. 107-229, as amended). The amounts included for 2003 in this budget reflect the Administration's 2003 policy proposals.

Explanation of Change

Decreases from the FY 2003 request reflect elimination of advance appropriation.

ELK HILLS SCHOOL LANDS FUND

Program Mission

Pursuant to Public Law 104-106, the National Defense Authorization Act (the Act) for FY 1996, DOE sold Naval Petroleum Reserve 1 (Elk Hills). Section 3415 of the Act required, among other things, that the Department make an offer of settlement to the State of California with respect to its longstanding claims to two parcels of land ("school lands") within NPR-1. The Act also provided for 9 percent of the net sales proceeds to be reserved in a contingent fund in the Treasury for payment to the State, subject to appropriation. The Department's estimate of 9 percent of the net sales proceeds is $324 million, of which $298 million has already been deposited into the contingent fund. The Department will adjust the amount in the contingent fund once all divestment related costs have been paid.

In compliance with the Act and in order to remove any cloud over title which could diminish the sale value of the Reserve, the Department entered into a Settlement Agreement with the State on October 11, 1996. The Agreement calls for payment from the contingent fund to the State, subject to appropriation, of 9 percent of the net sales proceeds, payable over a seven-year period (without interest), commencing in Fiscal Year 1999. Under the Settlement Agreement, the first five installments are for $36,000,000 each year, and the remaining balance is to be paid in two equal installments in years six and seven.

The first installment payment was appropriated in FY 1999. No appropriation was provided in FY 2000, but the FY 2000 Interior and Related Agencies Appropriations Act provided an advance appropriation of $36 million, which was paid in FY 2001 (second installment). The third and fourth installments of $36 were paid at the beginning of FY 2002 and FY 2003 respectively. The pending FY 2003 Appropriations Act contains funding for the fifth installment and The FY 2004 request of $36 million is a placeholder for the sixth installment.

Program Strategic Performance Goals

Complete the requirements of the Settlement Agreement with the State of California.

Performance Indicator

- Installment payments

Annual Performance Targets and Results

FY 2002 Results	FY 2003 Target	FY 2004 Target
Made third installment payment ($36 million).	Make fourth installment payment ($36 million) & provide advance appropriation for fifth installment payment ($36 million).	Make the sixth installment payment ($36 million placeholder pending completion of divestment activities).

Funding Profile

(dollars in thousands)

	FY 2002 Comp. Approp.	FY 2003 Request	FY 2004 Base	FY 2004 Request	FY 2004 Request vs. Base	
					$ Change	% Change
Elk Hills School Lands Fund	$0	$36,000	$36,000	$36,000	$0	0%
Advance Appropriation	$36,000	$36,000	$36,000	$0	$-36,000	-50%
Total, Elk Hills School Lands Fund	$36,000	$72,000	$72,000	$36,000	$-36,000	-50%

Funding by Site

(dollars in thousands)

	FY 2002	FY 2003	FY 2004	$ Change	% Change
State of California	$0	$72,000	$36,000	$-36,000	-50%

Site Descriptions

The Agreement calls for payment from the contingent fund to the State of California, subject to appropriation, of 9 percent of the net sales proceeds, with respect to its longstanding claims to two parcels of land ("school lands") within NPR-1.

Detailed Program Justification

(dollars in thousands)

	FY 2002	FY 2003	FY 2004
Elk Hills School Lands Fund	$36,000	$72,000	$36,000

Reflects the $36 million placeholder for year six of seven as required by the Settlement Agreement. The Agreement calls for payment to the State of 9 percent of the net sales proceeds, payable over a seven-year period, without interest.

FY2003 and FY2002 provided funding for installments 3, 4, and 5.

Explanation of Funding Changes

	FY 2004 vs. FY 2003 ($000)
Production and Operations	
▪ Decrease reflects elimination of advance appropriation	-36,000
Total Funding Change, Elk Hills School Lands Fund	**-36,000**